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Hepburn, Alonzo Barton

The relation of life
insurance to the credit...

[New York]

[1914]

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"Betterment of Life Insurance Service"

THE RELATION OF LIFE INSURANCE TO THE CREDIT FABRIC OF BUSINESS

BY

HON. A. BARTON HEPBURN

Chairman of the Board of Directors, Chase National Bank, New York.



An Address delivered at the Eighth Annual Meeting of
THE ASSOCIATION OF LIFE INSURANCE PRESIDENTS
at New York, December 10, 1914

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*Chairman of the Board of Directors, Chase National Bank,
New York*

AN ADDRESS DELIVERED AT THE EIGHTH ANNUAL MEETING OF THE
ASSOCIATION OF LIFE INSURANCE PRESIDENTS IN
NEW YORK CITY ON DECEMBER 10, 1914

I am asked to discuss "the relation of life insurance to the credit fabric of business," from the viewpoint of a banker.

In 1879 I was Chairman of the Assembly Insurance Committee of the New York Legislature, a position unsolicited and undesired, but a position which forced upon me more or less study of the subject of life insurance. The Continental, Knickerbocker, Globe and other companies failed, and the failures were bad ones; public sentiment was greatly aroused and the demand for immediate legislation was importunate. All attempts at legislation that year failed, because every measure was loaded down with punitive provisions, *ex post facto* provisions, not only unwise but unconstitutional. It required the lapse of a year for the temper of the public to cool down sufficiently to permit of the enactment of wholesome legislation.

In 1879 the total resources of the Prudential Insurance Company were \$201,891, and outstanding insurance was \$3,866,913; in 1913 the total resources of the Prudential had grown to \$335,478,783, and outstanding insurance, ordinary, to \$924,362,877, industrial, \$1,462,515,043. In 1879 the resources of the Metropolitan Life Insurance Company were \$2,022,482, and its total outstanding insurance amounted to \$11,150,349; in 1913 the total resources of the Metropolitan were \$447,972,405 and outstanding insurance, ordinary,

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amounted to \$1,038,089,393—industrial insurance amounted to \$1,778,415,069. The aggregate resources of the New York Life, Mutual, Equitable, Prudential and Metropolitan were, in 1879, \$166,296,822, and their aggregate outstanding insurance was \$603,553,606. According to their reports for 1913, the aggregate resources of these companies had grown, in the intervening 34 years, to \$2,694,591,746, and their outstanding insurance had reached the enormous total of \$7,325,711,135 of ordinary insurance, and including the industrial insurance of the Metropolitan and Prudential, the grand total reaches \$10,566,042,247.

I have presented these figures in this way, in order to emphasize the fact that these institutions are the greatest investment banks in the world; and indeed they practice a measure of commercial banking, since life insurance companies have adopted the policy of loaning to the insured upon their policies as collateral. A contractual obligation is written into the policies, whereby they agree to loan a certain percentage of the surrender value at a fixed rate of interest at any time when the insured may require the same. Policyholders are coming to realize this privilege and the volume of these loans is constantly on the increase. The aggregate amount of such loans, according to the 1913 reports of the five companies above named, was \$356,280,312.92. Such loans, of course, offset and reduce the amount of insurance. Such disadvantage must be more than counterbalanced, in the opinion of life insurance managers, by the commercial value, the availability as collateral, which the borrowing privilege gives to the policy.

The asset side of life insurance may be classified as banking—in one form or another. Should not the banking character of life insurance companies impose upon them, measurably, the same obligation to support the credit fabric of the country, as rests upon other forms of banking? If savings banks, trust companies and commercial banks are required by law to keep a reserve against their liabilities, should not life insurance companies, in the conservatism of good management, keep liquid funds available in case of need? Should not the liquid character of their assets contribute to the general protection of the public credit in times of stress and stringency? I by no means lose sight of the differentiation between life insurance and banking, and I am not advocating fixed legal requirements of reserve, but in view of the policy loans to the insured, it can no longer be said that a man must die before any demand upon the company can result from his policy of insurance.

My understanding is that the wisdom of such a general policy

was recognized and practiced up to the time of the recent insurance investigation. Then large bank balances were paraded, coupled with the charge that they were excessive, maintained as a matter of favoritism in institutions whose stock was largely owned by the trustees, or where the trustees were especially favored in respect to loans. To the extent to which such charges were true, it represents, of course, a wrong which rightly called for correction. That time and those conditions have passed, however, and the proper relation of life insurance management to the credit fabric of the country is, it seems to me, a question of importance calling for careful consideration on the part of life insurance managers.

As to the liability side, the functions of an insurance company are not eleemosynary; they do not give alms, but they do sell protection, they insure against the extremes of misfortune and graduate the vicissitudes of life; they are not money-making institutions, but enable the general public to mutualize their strength and helpfulness, and minimize the loss and hardship which would otherwise exist. That is the attitude which the companies have assumed and which the public have accepted, and now insist that such relationship shall be maintained.

Some companies are capitalized, but public sentiment limits dividends to a very moderate percentage, and insists that all overplus earnings be held for the benefit of the policyholders. All companies are essentially mutualized in their administration; the amount received in premiums exceeds the amount paid for losses only by an amount representing the cost of management and a proper and wholesome reserve. All benevolent work deserves commendation. The figures I have given you, showing the growth of life insurance in force, show the public appreciation of this greatest of all humane instrumentalities for equalizing the burdens and alleviating the sufferings of mankind, which would otherwise exist. Time was when a life insurance agent had to weave a spell, to fascinate with fluent phrase to induce the sale of a policy. Now, if a business man is known not to have a life insurance policy, it excites the query, "I wonder why?" Of course the premiums exceed the death losses, and long years of payment enable the companies to meet the presently occurring losses. I have never known anyone to regret these constantly recurring payments, year after year, and all the while the insured has had protection. Anxiety and worry yield to the comforting conviction, day by day, that his insurance will enable his estate to make full restitution to those who have given him their confidence and credit, or better still, that his insurance will care

for and maintain his loved ones when his supporting hand no longer avails.

The Good Book tells us that "a contented mind is better than great riches." Life insurance has been most effective in bringing the contented mind within the reach of all.

Life insurance companies and banks both deal in credit and subside upon credit, and both draw from the public the financial resources with which they in turn serve the public. The reservoir, filled by the inflowing stream of premiums, is drained by the outgoing current of ascertained losses. The asset side of life insurance deals wholly with credit; on the liability side, your outstanding insurance depends upon your credit with the general public, upon their belief in the honesty and efficiency of your management and your financial ability to meet the obligations contained in such insurance. You would not insure a known crook, however flattering your physicians might report his physical condition to be, nor would a bank make a loan to a known crook, however choice the collateral offered might be. To quote the late J. P. Morgan, "Character is fundamental in all business transactions, or should be." The exigencies of business compel us to have arm's length relations with all sorts of people, but we establish a community of interest only with those whom we trust and whose character we believe to be worthy and well established.

Fifty or sixty years ago banks of this country did business upon their capital, reinforced, in many instances, by the issue of bank note currency. The money of the people and corporations was in active use—bank deposits were negligible. The growing wealth of the country has changed this, and now the business of banking is done upon deposits, capital and surplus being only sufficient in amount to margin the business and command public confidence.

The individual wealth of our citizens has made bankers more and more dealers in credit, by furnishing the major part of their banking power, by giving the banks credit, in form of deposits, as well as by utilizing their credit with the banks. If a man or corporation wished to open an account, the line of investigation as to the individual or the individuals managing the corporation would first be directed to their character, honesty, temperance, sobriety, industry, forethought, efficiency, prudence, the quality of looking ahead and providing for eventualities, and their financial resources and property strength.

The initial inquiry would naturally take the form of a personal interview, and at some point in such an interview between a banker

and a would-be depositor or debtor, the inevitable inquiry would suggest itself, "Have you any life insurance, and if so how much, and in what companies? Does it run to your estate, or to some named beneficiary?" Such an inquiry would be important because of its bearing upon his financial power, but vastly more important as showing his trend of mind, the extent to which he assumed personal responsibility, whether he was caring for the present and immediate future only, or whether the range of his vision and his activities looked to the protection of his estate and his family after his demise. (We live under the shadow of the Stock Exchange, and it may be well to remark that money on the Exchange is, theoretically at least, loaned to the highest bidder, and such loans are an exception to all usual credit rules.) The quality of mind which induces one to take out life insurance is the quality of mind that best insures success in business.

The business of the world is dependent almost entirely upon the maintenance of credit relations among men. If we ever lose sight of this fact, its truth is presently borne in upon us by some financial depression, panic, great labor strike, or war.

Business transactions on a large scale, such as we of this age have become accustomed to regard as matters of course, but which would have been the marvel of earlier generations, arise out of man's faith in the promises of his fellow-men. Agreements to do or not to do certain things, which in diplomatic circles may sometimes be regarded as "mere scraps of paper," but never in business circles, afford the means by which commerce of present-day magnitude is carried on throughout the world. Credit of the kind we are considering may almost be defined as man's faith in man and in man-made institutions.

We have established a new banking system, to the end that we may have better credit facilities. The President of the United States took occasion to refer to the importance of the event, saying, among other things, that "credit is the very life of trade; the very air men must breathe if they would meet their opportunities." And so, indeed, it is.

It is almost as difficult to separate the matter of credit from our daily deals and examine its constituent elements, as it is to isolate a particular bacterial cell from thousands of others for the purpose of studying its peculiar characteristics, so intimately is credit intermingled with every business transaction. Even in sales where men feel that they are trusting nobody, we find credit involved in the currency that is being paid in the "cash transaction."

The machinery of credit is made up of Governmental agencies, banking institutions, customs of business, courts for the enforcement of contracts, and in many other practical devices having their origin in law. But underneath the great superstructure lies the credit foundation, consisting of ability and determination on the part of men to meet their obligations at maturity.

It has been the custom of business men, in extending credit, to lay much stress upon financial ability to pay, and this element, coupled with laws which make it possible to enforce payments when property is available for that purpose, is of great importance. But does not the average business man put too much emphasis upon a man's financial ability to pay, and too little upon those personal traits which are comprehended within the general term "determination to pay"? In other words, do we not pay too much attention to property qualifications and too little to personal qualities? The law's delays and the law's circumvention permit property to melt away, but the element of personal honesty and the quality of efficiency do not change with time.

With such thoughts in mind it is interesting to note the activities of life insurance companies, in urging life insurance, as a means of circumventing the disaster almost sure to follow, in cases where death removes from the management of a business the man whose foresight and ability have made the business a success. Of course, the mortality chances in such cases, under the law of average, may not be very great, but they are chances which a concern, dependent largely upon one life, may well hesitate to take. Hence, the growing custom, to shift the risk to a company, which, by insuring many lives, invokes the law of average, thus making certain that its losses shall not in the aggregate be abnormal. I am told that this kind of insurance is now being written in large amounts to cover, not only the dependence of one partner upon another, but also of corporations upon their managing geniuses, their inventors and other persons upon whom success is largely dependent. Life insurance is also being made to serve the useful purpose of insuring creditors against the death of debtors whose ability to pay their debts is more dependent upon their living than upon the amount of property they may own. I borrowed money to finish my education, and had my life insured as collateral. The party making the loan believed I would repay the same if I lived, and that the insurance company would if I did not. These useful functions tend to remove uncertainty and chance of loss from daily business transactions, which is most

important in establishing and maintaining credit relations. It shows how rapidly and how intimately life insurance is being interwoven with current business.

There is another feature of life insurance about which I would like to speak, and on which I would lay much emphasis, because I feel that it has not been fully appreciated. I hardly know what to call it, unless it be the psychological significance of life insurance as it should be viewed from a creditor's standpoint.

When it comes to extending credit, the average business man does not, perhaps, have in mind any set of rules or formulae. He does not attempt to analyze and catalogue the qualities the applicants should possess, as a basis for the credit they ask. He reaches a conclusion by the short cut to which he is accustomed, viz.: the man's manner, appearance, reputation, financial standing, and somewhat by his words and promises. He should in some way, either general or specific, by inquiry or intuition, seek and obtain answers to a number of questions such as these: Has the man ability, self-control, prudence and forethought? Is he cautious, frugal and normal in his habits of life? Has he a sense of justice and a proper regard for the rights of others? Is he accustomed to assume responsibility, and does he understand the need for being prepared to meet emergencies? Is he home-loving, industrious and mindful of duty? Is he progressive, and likely, therefore, to keep pace with his competitors? Does he know how to get money's worth for money expended? Is he fickle and erratic, or are his habits fixed and his purposes in life well-defined? Has he integrity and reputation and does he cherish his standing among his fellowmen? Is he selfish and self-centered, or does he think of others, and especially of wife, children and those who may be dependent upon him?

Surely it will require no argument before a group of life insurance experts to prove that a careful and detailed inquiry as to the life insurance a man carries would shed light upon each of the questions I have attempted to formulate and to which many others of similar import might well be added. Suppose, for example, in seeking information as to a man's forethought, prudence, caution, frugality, unselfishness, reliability and other qualities which go to make up high character and good repute, we should ask how much life insurance he carries, of what kind and for how long has it been carried, in what companies has it been taken out and is it for the protection of the family or the business or both? Could we find anywhere better evidence of the working of the

man's mind, of his habit of life, of his sense of responsibility, and, in fact, of all those qualities upon which we must rely for fulfillment of promises so far as personality is concerned? Of course, inquiries concerning a man's life insurance will not answer all of the questions involved in the matter of extending credit, nor any of them conclusively, but I doubt if there is any one line of inquiry that could be made of a man who has reached middle age, after having been engaged in business for several years, that would come as near showing both ability and determination to meet obligations and keep promises.

The need for making such inquiries is of growing importance. There was a time when it was the rule, even among conservative business men, to carry largely, if not entirely, risks of fire, accident and death, against which to-day it is almost the universal custom to insure. Then a lack of life insurance did not carry special significance. Now the failure of a man to take the precautions which are commonly taken by his fellowmen is a fact of such importance as to put the prospective creditor on notice, and call for careful inquiry as to why he thinks he can disregard what has come to be the common judgment of mankind. Or, to put it another way, the man a generation ago who carried life insurance of large amount was so exceptional as to excite inquiry as to his reasons and motives for so doing, while to-day it is the man who thinks he can afford to do without life insurance that is subjected to inquiry.

Banks have long been accustomed to ask large borrowers for a statement of the life insurance they carry, and it seems to me that commercial agencies, like Dun's and Bradstreet's, should ask for similar information for use in reaching a conclusion as to the credit-rating to which a man is entitled. Such information is certainly valuable contributory evidence.

In urging the psychological element in credit transactions, as disclosed by the life insurance a man carries, I have in mind largely those dealings in which security is neither asked nor expected—dealings in which property is exchanged for mere promises to pay. As to such transactions, faith is, and must be, put in a man who makes the promise and in his habits of mind and conduct, which have crystalized into what we are accustomed to term reputation. I fear we sometimes overlook the fact that in making inquiry about a man's property and the profitableness of his business, we are really seeking information concerning the qualities which have led to his success in business. It has occurred to me that the com-

bined records of life insurance companies, showing those who have insured and carried insurance for some time, those who have borrowed on their policies, and those who have not committed this offense against their beneficiaries, would afford an excellent credit-rating of the men whose names would thus appear. It is almost regrettable from the credit standpoint that such information must be deemed confidential by the life insurance companies. Men seem to pride themselves upon their property ownership and do not object to its being known in business circles, partly, no doubt, because this is customary and generally regarded as evidence of the possession of those characteristics which give reputation and standing among their fellowmen. Would not public knowledge of the insurance they carry also contribute to their credit-standing in the community?

The potent factor, the all-important factor in every business, is the management. Would you insure the machine and not the man? By every rule of prudence and conservatism, is not life insurance just as indispensable to credit as fire insurance?

Banking renders an indispensable service to the public and realizes its profit in the aggregation of very small percentages in multitudinous transactions. It is managed as a business and for gain. Life insurance management seeks no profit in the usual sense of that term; it holds and uses all net earnings for the benefit of the insured; the insured seeks no personal profit or advantage, but strives to protect his credit, shield his family and soften for them the asperities of life after he has passed beyond the realm of personal activity. Life insurance is unselfish, it is the tangible result of the better motives of human nature embodied in the form of practical relief; although interwoven with and closely allied to business, its impulse and its execution are sociological, altruistic; it is the regard for one's credit and the love for one's family, incarnate in tangible, enforceable contract, a beneficent instrumentality, which enables the dead hand to control, in order to sooth, assuage, cherish and support.

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- The Impropriety of Taxing Returns to Life Insurance Policyholders. By Robert Lynn Cox, General Counsel and Manager, Association of Life Insurance Presidents. February, 1909.
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Railroad Securities Should be Treated as Local Investments for Life Insurance Companies. By Walker D. Hines, Chairman Executive Committee, Atchison, Topeka and Santa Fe Railway. December, 1912.
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The Ultimate Effect of an Unrestricted Right to Borrow on Life Insurance Policies. By Arthur E. Childs, President, Columbian National Life Insurance Company. December, 1913.

Are You Borrowing from Your Widow? Containing statistical evidence dealing with the growth of the policy loan problem, by Robert Lynn Cox, General Counsel and Manager, Association of Life Insurance Presidents, and also other discussion of the same subject. December, 1913.

Bequeathing Our Debts. Views and suggestions of representative newspapers, taken from their editorial pages, on the policy loan problem. March, 1914.

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Taxation

- Injustice and Inequality of Life Insurance Taxation. Report of Committee Adopted by National Convention of Insurance Commissioners. August, 1908.
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- Modern Co-operative Methods to Meet Modern Tendencies of Government Control. By Robert Lynn Cox, General Counsel and Manager, Association of Life Insurance Presidents. October, 1910.
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